

# Increasing Cross Border Investment in COMESA

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## An Investor Roadmap Approach

A Presentation to the Executive Officers of  
The Investment Promotion Agencies of  
COMESA Member States

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Booz Allen Hamilton

## Defining the Problem: COMESA Wants More Investors to Make Regional Investments in COMESA

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- What can COMESA do to improve the investment environment such that investors are more likely to expand their operations into other COMESA countries?
- Assumption: Market forces will ultimately dictate the amount and patterns of investment within the region.

## Issue 1: Return on Investment - Investors Invest to Make Money . . .

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"Business. It's all about return on investment. Think about it. There's a finite amount of money available. If it runs out, game over. And if you make a sizeable ... investment in your company, you'll want to see a return."

IBM advertisement, *The Economist*, Sept. 22-28, 2001, p. 19

## Investors' Decisions Are Made Solely on the Basis of ROI, *and Nothing Else*



## Investors Determine Return on Investment by Analyzing 4 Components, Either Explicitly or Emplicitly

$$\text{ROI} = F ( \frac{\overset{\textcircled{1}}{\text{Revenue}} - \overset{\textcircled{2}}{\text{Cost (Profit)}}}{\underset{\textcircled{3}}{\text{Investment Cost}}} \times \overset{\textcircled{4}}{\text{Risk}} )$$

## Each Component Consists of a Series of Factors

Component	Market Factors	Governed Factors
Revenue	Competitiveness, Market size	Consistency in applying tariffs
Cost of Doing Business	Input costs (labor, transportation, raw materials, utilities)	Regulations, taxation, access to market
Investment Costs	Land values, market research, equipment costs	Availability of Land, Communications, Tariffs
Risk	Threat of Competition, Exposure to Economic Changes	Dynamic Legal Environment, Strength of Commercial Courts

## Governments Influence Return on Investment

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- Reducing initial costs by providing information and facilitating investment
- Increasing revenues by providing a level playing field
- Reducing costs by eliminating constraints through improved service infrastructure (e.g., import/export bureaucracy)
- Reducing risks through consistent application of laws and policies

## **Governments Should Lower Cost of Investment by Providing Information**

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- Investors interviewed understood little about other COMESA countries' marketplaces.
- There was a significant cost to acquiring information. In most cases it meant extended trips for management.
- Investors did not perceive that there would be a reasonable return on this type of investment.



## **Governments Must Influence Revenues by Establishing a Level Playing Field**

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- For the most part, companies' abilities to maximize revenues are predicated on their own ability to compete in the marketplace.
- Governments have a role to play in ensuring marketplaces remain fair. The biggest complaint came from accusations of duty and tax evasion.
- By reducing corruption at the borders, countries can improve the competitive environments in which their companies compete.

## **Governments Have the Ability to Reduce Costs of Doing Business**

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- Bureaucracy adds significant costs to businesses.
- By limiting access to service infrastructures, governments have inadvertently raised costs of doing business.
- Government policies on land, labor, and utilities can profoundly affect the costs of operations.

## **Governments Should Reduce Risk through Consistent Application of Laws and Policies**

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- Transparent, predictable processes allow investors to quantify their risks
- Consistent implementation of policies reduces non-market uncertainties

## **Sub-Saharan African Companies Boast the Highest Return on Investment - There is a Reason for This**

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- Investors perceive that investing in the region entails a high risk. In this case perception is reality.
- Because of this risk, companies only take on projects that have potentially very high returns on investment. They avoid the more mundane, low return projects.
- The perception of risk is greatly exacerbated by a lack of information regarding investment destinations. Governments can address this.

## Issue 2: The Public and Private Sectors Both Want More Investment but Differ on What That Means

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- Public Sector - focuses on productive investment, either in buildings, machinery, or equipment
- Private sector - any sunk cost that's intended to generate a return. Examples include:
  - costs of travel
  - costs of communications
  - purchases of equipment

## Most Governments Do Not Recognize that Investors Enter a Market Gradually

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- Selling from home country
- Establishing relationships with local distributors
- Establishing a distributorship
- Building a warehouse
- Building an assembly plant
- **Building a factory**

## **Governments Must Broaden Their View of Investment in Order to Attract More of the Fixed Asset Investment They Want**

- By discriminating against intermediate steps of investment, they reduce overall investment
- But by improving the environment for all stages of investment, “high-end” investors will also be attracted

## The COMESA Regional Investors' Roadmap

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Methodology and Findings



## Investors Interviewed Were Reluctant to Invest in Additional COMESA Countries

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- Many simply cited their lack of knowledge of opportunities elsewhere.
- Operations were small in most businesses: small enough that management couldn't afford to leave for the time it would take to set up a new business
- Steel and steel products seems to be the industry most likely ready to expand.

## We Studied 4 Industries in 10 Countries

	Steel	Clothing	Leather	Oil Seed
Ethiopia			X	X
Kenya			X	X
Malawi	X	X		
Mauritius	X	X		
Namibia	X	X		
Tanzania			X	X
Uganda			X	X
Zambia	X	X		
Zimbabwe	X	X		

## The Four Industries Have Many Differences

	Steel	Clothing	Leather	Oil Seed
Market-place	Primary Local	Mostly Foreign	Foreign	Local
Cost of Transport	Very High	Low	Low	Medium
Protection	Not much	None	None	Considerable
Value Added	Low	Low-High	High	Low
Market	Industry	Primary Consumer	Consumer	Consumer

## The Four Industries Have Many Differences (Cont.)

	Steel	Clothing	Leather	Oil Seed
Capacity	At Limits	Excess Capacity	Excess Capacity	Excess Capacity
Foreign Competitor	South Africa	Asia, SA	Europe, Asia	Asia
Market Opportunity	High	Low	Very Low	Medium
Upstream Value Added Opportunity	Low	Medium	High	Low

## **We Also Compared and Analyzed National Investor Roadmaps for Common Themes**

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- National studies deal with domestic impediments to investment
- These studies were undertaken over the last 6 years
- 8 countries were covered (Kenya, Malawi, Mauritius, Namibia, Swaziland, Tanzania, Uganda, & Zambia)
- Common problems were identified regarding cost of investment and cost of doing business

## Regional and National Roadmaps Identified Common Problems

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- It is very difficult to bring in foreign expertise to virtually any COMESA country
- There are significant bureaucratic costs and delays associated with many different legally required government transactions
- Serviced land is not readily available for investors in many countries

## Industry: Leather

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- The market for final goods is primarily external. Downstream manufacturers have primarily located close to the marketplace.
- Tremendous overcapacities exist at the raw material processing levels, particularly tanneries.
- Raw material qualities leave much to be desired. There is a distinct absence of foreign participation in the raw material processes.
- Producers are not aware of the standards of the markets where their goods are sold.

## Industry: Steel

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- The marketplace is local, but shortages in raw materials and capacity exist.
- Transportation costs create natural “duties”.
- Information is sorely lacking from country to country. Major opportunities exist for local manufacturers to expand.



## Industry: Oil Seed and Cooking Oil

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- The marketplace is local, with export potential limited to specialty seeds.
- Raw material production does not meet local demand for processed oils, which is met in great part through foreign imports.
- Heavily protected borders limit economies of scale, so that
  - Production capacity is underutilized
  - Markets are not yet regional

## Industry: Clothing and Textiles

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- The influx of used clothing creates a dilemma for policy makers. This will become a regional issue.
- For some countries, the marketplace for locally made goods is next to non-existent.
- Most of these industries are labor intensive. The combination of productivity rates and costs make many countries uncompetitive on the world markets.

## Recommendations Resulting From the Industry Conclusions Fall Into Seven Categories

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- Administrative and Bureaucratic
- Enforcement and Compliance
- Finance
- Information
- Policy Harmonization
- Private Sector Capacity
- Transport

## Recommendations Regarding Bureaucracy Were Largely Consistent from Country to Country

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- It is recommended that the employment of expatriates be made easier
- It is recommended that steps be taken to improve coordination between agencies
- Transparency must be improved between government agencies
- Duty drawback schemes are not working as envisaged
- Licenses are not recognized from other Member States

## In Many Cases the Legal Environment is Correct But Enforcement is the Issue

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- Administrative decisions must be made transparently
- Steps should be taken to ensure customs duties are applied consistently
- COMESA should establish a mechanism to anonymously report corruption
- The COMESA Court of Justice should determine how it can raise the confidence in Member States' judiciary systems

## Recommendations Apply to Financial Constraints Faced by Investors

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- COMESA (through PTA) should look towards expanding the range of secured financial offerings available.
- COMESA should establish a commission on land and property rights
- COMESA (or PTA) should act as clearinghouse for donor-backed lending programs in the region.

## **COMESA Must Overhaul and Significantly Upgrade Its Information Dissemination Activities**

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- COMESA marketing materials must be part of an overall image building campaign for the region
- COMESA should maintain an accessible library of market research studies
- COMESA should help to publish all Member States' tenders region-wide
- COMESA must clearly define the difference between itself and other regional organizations.
- COMESA should develop its database on laws and regulations within Member States.

## COMESA Should Continue to Harmonize Policies In the Following Areas

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- COMESA must ensure that Member States do not raise ad hoc tariffs.
- COMESA should look at harmonizing environmental laws
- With the coming of the CET, COMESA will have to address the importation of used clothing



## COMESA Should Continue its Role Building Private Sector Capacity

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- COMESA should work with educational institutions to ensure that the training meets the needs of the local market
- COMESA needs to urgently push forward local quality assurance programs
- COMESA can help coordinate donor training programs

## COMESA Has Made a Large Impact on Transportation - It Can Do More

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- COMESA should implement single-stop border crossings
- COMESA should accelerate the implementation of the bond guarantee scheme.